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CHINA'S AVIATION SECTOR

Issues and Background

According to Chinese and foreign estimates, China's domestic air traffic growth will remain among the world's highest in the foreseeable future, rising by 20 to 25 percent annually through 2000 before slowing to 10 to 15 percent during the next decade. Chinese authorities recognize that the country's aviation infrastructure is unable to handle such traffic and, to keep pace, are initiating a massive increase in spending:

- Press reporting suggests that Chinese airport spending alone will range between \$1 billion and \$2 billion annually over the next six to 10 years. The Civil Aviation Administration of China (CAAC)—China's air service oversight authority—last year launched a \$5.5 billion program to build or renovate 100 airports by 2000, tripling airport capacity to 180 million passengers. Independent provincial and Hong Kong funding will generate \$4-9 billion for these and additional projects.
- CAAC officials also estimate the country will need to import some 800 mid- and large-capacity passenger aircraft worth \$45 billion. The program will double China's aircraft fleet to 960 by 2010, making China the world's third largest aircraft market—after the United States and Japan.

Moreover, a poor safety record—plagued by numerous small incidents and blackened by a tragic crash of a China Northwest airliner in Xian in June—has prompted Beijing to ground all Soviet-built TU-154 planes. This is likely to lead to increased purchases of Western aircraft, and spur Beijing's efforts to develop—in conjunction with a number of partners—its own 100-seat regional jet.

China's budget deficit—which officials estimate will reach a cumulative \$15 billion this year—as well as a burgeoning aviation goods trade deficit is prompting Beijing to use its import market to entice Western companies into financing infrastructure expansion as well as forming aviation manufacturing joint ventures and coproduction arrangements. CAAC last year announced plans to phase-in foreign management as well as investment in all airport construction and operations—except navigation, which will remain under Chinese control because of security concerns. Press reports indicate that over the next six to 10 years CAAC officials are hoping to generate more than \$7 billion in foreign funds, possibly by offering 50-year operating contracts on airports handling substantial foreign traffic; these facilities offer more rapid returns on investment by generating hard currency through user fees and airport hotel earnings. China is also seeking foreign low-interest loans and to raise funds through stock and bond issues.

US Angle. China's aviation infrastructure expansion and manufacturing upgrade programs will offer considerable opportunities for Western, and particularly US, exporters. US companies already command roughly 85 percent of China's aircraft, aircraft parts, and engines market, according to official trade data, with 1992 sales reaching more than \$2.2 billion; for aircraft alone, the United States holds nearly 90 percent of the market. Indeed, such goods are among the United States' most successful exports to China, accounting for nearly 30 percent of total US sales to that country in 1992. Similar statistics for air traffic control (ATC) equipment sales are not available from Chinese or international sources, but anecdotal evidence suggests that European and Japanese firms dominate this emerging market.

Several factors argue for continuing US dominance of China's aircraft and aircraft parts market; purchasing patterns and plans suggest that US sales over the next 10 to 15 years could range between \$33 billion and \$36 billion. Chinese aviation technicians and flight crews are familiar with US equipment--while expanding imports from Europe would require expensive retraining--and press reports indicate that local factories prefer working with US manufacturers because CAAC's airworthiness standards are based on US versions.

US ATC technology is often more expensive than its competitors, but Chinese officials perceive US equipment as more advanced and reliable, according to press reporting. CAAC buying delegations over the past two years have frequently visited this country seeking flight information processing systems and systems integration equipment for linking ATC sites. Based on China's ATC upgrade plans, we expect exports to increase in other areas of relative US technical superiority, including navigational aids, meteorological equipment, ticketing and services computer systems, runway lighting, flight information displays, and ground support vehicles. US firms may capture between 25 percent and 30 percent of this market, with sales reaching \$125-300 million annually over the next six to 10 years. Additional sales opportunities exist among the plans of several large airlines to acquire technologies such as flight calibration aircraft--used to verify the accuracy of land-based navigation aids--as well as ancillary airport projects such as power plants and high-speed rail systems connecting airports to population centers.

Despite their advantages, US aircraft-related exporters and investors face several challenges that over the next 10 to 15 years may reduce their overall market share. Airbus Industrie, for example, recently announced plans to expand small parts sourcing from China as well as open a pilot training center and an after-sales service office in Beijing. US ATC manufacturers may also be at a disadvantage relative to their Japanese competitors because at least 24 airport upgrade projects are being underwritten by \$300 million worth of low-interest loans from the Tokyo-backed Japanese Overseas Economic Cooperation Fund.